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An Ounce of Prevention

Oversight of Disaster Reconstruction Activities in Central America and the Caribbean

The United States Agency for International Development (USAID) is the federal agency charged with managing most of the U.S. Government's international economic assistance activities. USAID's overseas offices—called missions—work with local governments and non-governmental organizations (NGOs) to design development activities and then award contracts and grants to bring these activities to fruition. USAID has a statutory Inspector General who is responsible for directing audits and investigations of USAID's programs. The USAID Office of Inspector General (OIG) performs proactive activities to prevent waste and fraud.

Hurricane Mitch

Hurricane Mitch, the most destructive storm in the region in decades, stalled over Central America from October 26 through November 5, 1998. The torrential rains resulting from this almost stationary hurricane caused massive loss of life and damage to homes, schools, roads, water and sanitation systems, and other infrastructure. Honduras was the hardest hit, with 13,709 people reported killed and missing and approximately 1.9 million people affected by the disaster. Nicaragua also suffered severe damage, with 3,747 people reported killed and missing and 867,752 people displaced by the storm. Guatemala and El Salvador suffered lesser, but still serious, damage from the hurricane. Economic damages throughout Central America were estimated to exceed \$5 billion—an amount far beyond the capacity of the local governments to absorb.

U.S. Government Response

The U.S. Government responded immediately with emergency relief supplies, emergency Food for Peace aid, and other assistance totaling more than \$300 million. While this emergency assistance helped relieve suffering and met some of the most pressing needs for shelter, food, clean water, and medical supplies; longer-term reconstruction needs had to await the commitment of additional resources.

To address these longer-term reconstruction needs, on February 16, 1999, the Administration requested a supplemental appropriation of nearly \$956 million. The package approved by the Congress and signed into law on May 21, 1999 provided \$621 million. Most of the funds were destined to assist the countries affected by Hurricane Mitch, but the supplemental appropriation also included about \$52 million to address the effects of

Hurricane Georges in the Caribbean and an earthquake in Colombia.

Both the supplemental appropriation request and the enacted law envisioned that many federal agencies, in addition to USAID, would participate in the reconstruction program. Ultimately, the departments and agencies participating in the program included the U.S. Army Corps of Engineers, the Department of Transportation, the Department of State, the Department of Housing and Urban Development, the Department of Commerce, the Department of Agriculture, the Department of Health and Human Services, the Peace Corps, the Export-Import Bank, the Overseas Private Investment Corporation, the Environmental Protection Administration, the Federal Emergency Management Agency, and the U.S. Geological Survey.

Oversight Strategy

In the aftermath of Hurricane Mitch, all of the concerned parties—the Administration, the Congress, and governments and civil society organizations in Central America—saw a need for strong accountability and control mechanisms to make sure that the assistance reached the intended beneficiaries. Given the level of suffering in the region, the size of the U.S. Government's program, and the weak internal control and law enforcement mechanisms found in many countries in the region, it was easy to see how corruption—if it became widespread—could lead to political crisis and instability. No one wanted a repeat of the experience following Nicaragua's 1972 earthquake, when diversion of international assistance helped undermine the legitimacy of General Anastasio Somoza's regime.

Accordingly, the Administration requested, and the Congress provided, significant resources for accountability activities such as audits and investigations. The supplemental appropriation included \$1.5 million for the USAID/OIG to provide additional audit and investigative coverage of the programs funded from the supplemental appropriation, and provided \$500,000 to the U.S. General Accounting Office (GAO) to monitor the assistance.

To help make sure that disaster reconstruction funds were well spent, the USAID/OIG performed risk assessments of proposed activities, and developed a strategy that emphasized prevention and deterrence. For example, we developed a fraud awareness training program for USAID staff, host government personnel, contractors, and grantees. This training, which provided detailed, practical information in Spanish on how to prevent and detect fraud, was provided to over 2,100 people in the region. As another example, we helped USAID officials, grantees, and contractors strengthen internal control systems, including fraud prevention policies and procedures. We are using concurrent audits—an innovative approach to auditing on a real-time basis—to establish a highly visible field presence and

find accountability problems while they are still small and relatively easy to correct, too.

We performed risk assessments of proposed activities to decide what type of audit coverage was most appropriate. We considered the experience and audit history of the implementing organizations, the type of activities being financed by USAID, the controls and implementation arrangements that were established, and the amount of resources devoted to each activity. Based on these risk assessments, we arranged concurrent audits for the higher-risk activities and annual audits for lower-risk activities.

Concurrent financial statement audits, like all other audits of USAID funds supervised by the USAID/OIG, are performed in accordance with GAO's *Government Auditing Standards*. Concurrent audit reports, issued on a quarterly basis, include the auditor's opinion on the fund accountability statement,¹ a report on internal controls, a report on compliance with agreement terms and applicable laws and regulations, a report on cost sharing contributions, and a report on the status of recommendations from prior audits.² Concurrent audits differ from annual financial statement audits in that audit work is done throughout the year and more frequent reporting by the auditors is provided.

Concurrent audits are performed by private accounting firms, by Supreme Audit Institutions (SAIs)³, and by the Defense Contract Audit Agency (DCAA).⁴ In all cases the audits are closely supervised by the USAID/OIG. Specifically, we approve the scope of work, approve the audit program including detailed audit steps to be performed by the auditors, perform periodic on-site monitoring of the field work performed by the auditors, attend entrance and exit meetings wherever possible, approve the draft audit report, and approve the final audit report and issue it as an USAID/OIG work product. The audits performed by local accounting firms must be supervised by staff from the international firms they represent and the audit reports must be signed in the name of the international firm.

In addition to financial statement audits, we are conducting performance audits on disaster reconstruction activities. These performance audits have examined such issues as whether reconstruction activities are on schedule to achieve

¹ The fund accountability statement is a financial statement designed by the USAID/OIG that shows budgeted and actual expenses by line item, as well as any questioned costs identified by the auditor.

² Where agreements include provisional indirect costs rates, the audit report also includes a calculation of the final indirect cost rate and a report on the entity's general purpose financial statements.

³ SAIs may perform audits of USAID funds where they have been found capable to perform such audits by the USAID/OIG and where they have signed a memorandum of understanding (MOU) with the USAID/OIG and the USAID mission. The SAIs in Honduras and El Salvador have both signed such MOUs.

⁴ DCAA performs audit services for other Federal agencies on a reimbursable basis. DCAA has played a major role in auditing activities financed under the supplemental appropriation.

planned levels of service delivery, whether host governments followed competitive requirements in awarding contracts, whether USAID missions implemented adequate monitoring systems, and whether USAID missions properly processed and reported on advances and payments.

Results

To date, under our financial audit program, the auditors have completed fieldwork on 74 audits covering \$88 million in USAID funds. The audits completed to date have identified \$2.4 million in questioned costs, representing 3 percent of the amounts audited. These audits also identified 134 reportable internal control conditions and 124 instances of material noncompliance with agreement terms or applicable laws and regulations. Examples of internal control and compliance conditions reported include cases where:

- Entities that received funds from USAID awarded sub-grants or subcontracts to other organizations but did not adequately supervise their activities.
- Competitive procurement procedures were not followed.
- Work completed by grantees or contractors did not meet specifications.
- USAID funds were spent for ineligible items.
- Expenditures of USAID funds were not fully documented.
- Advances were reported as expenses.
- Local taxes were not withheld from payrolls.
- Supplies and materials purchased with USAID funds were not adequately safeguarded.

The concurrent audit program has been successful in identifying problems early on, when relatively small amounts are involved and the deficiencies are relatively easy to correct. Our expectation has been that, as time goes on, and these problems are addressed through our recommendation follow-up process, and the grantees and contractors gain experience with USAID requirements, we should begin to see fewer reported problems. This is in fact what we are seeing. There are some good examples where our initial concurrent audits identified some fairly significant

problems, including high percentages of questioned costs, but we have been successful in correcting those problems and subsequent audits have reported much lower percentages of questioned costs or none at all.

One such example would be the case of a non-governmental organization (NGO) in Honduras that is implementing a credit program to help reactivate the economy in the aftermath of Hurricane Mitch. Our initial concurrent audit on this NGO found that it, using USAID funds, made sub-grants to local organizations that did not have adequate accounting systems and, in one case, had not established a separate bank account to manage funds from the USAID project. As a result, the auditors identified \$338,894 in unsupported costs, or 36 percent of the audited amount. During subsequent concurrent audits of this NGO, the auditors worked very closely with the sub-grantees to help them set up reliable

accounting systems that would show how USAID funds were used. As a result, subsequent concurrent audits have reported relatively small amounts of questioned costs, ranging from two to three percent of the audited amounts. We think that we can continue to bring these amounts down even further through our concurrent audit program.

Our performance audit program has identified some cases where reconstruction activities have fallen behind schedule. In response, USAID missions, in collaboration with host governments, contractors, and grantees, have identified ways to accelerate progress. On a \$50 million roads and

bridges activity in Honduras, the USAID mission took numerous actions both before and following our audit to speed implementation of the activity. In response to the audit, the USAID mission, in consultation with the Government of Honduras, revised the planned accomplishments and developed an accelerated implementation plan that involved (1) using indefinite quantity contracts to shorten the time needed to award contracts, (2) awarding additional contracts to construction firms with available capacity, (3) permitting the executing unit flexibility to shift activities between geographic areas and contractors based on weather conditions and contractor performance, (4) adjusting selection criteria to ensure that only roads and bridges that can be completed by December 31, 2001 are selected for reconstruction, and (5) allowing the executing unit to hire additional staff.

The USAID/OIG has undertaken numerous proactive investigative efforts as well as more traditional criminal



investigations in response to allegations and leads developed during audit engagements.

Some Keys To Success

Thus far, the USAID/OIG strategy has been successful in limiting questioned costs and other types of deficiencies to a relatively low level—certainly, in our judgment, a much lower level than we would have seen had we not undertaken concurrent audits and other exceptional oversight efforts. What factors account for the successes achieved to date? Perhaps three factors were the most important:

- **Early Involvement**—We began to involve ourselves in the reconstruction program in November 1998, only days after Hurricane Mitch had ended. Substantive discussions and planning sessions continued through the Spring of 1999 while the Administration readied its supplemental appropriation request and while USAID missions designed their reconstruction programs. This gave us an opportunity to influence the design of controls for some programs and gave us some concrete information on what our customers and potential customers wanted from us.
- **Participation and Teamwork**—We developed our oversight strategy through a participatory, iterative process that included USAID management, congressional staff, host government officials, contractors and grantees, GAO, representatives of OIGs from other federal agencies, and representatives of other international donors that are active in the region. Each of these groups made substantive contributions to the strategy. We also encouraged wide participation in the oversight program itself. For example, the fraud awareness training provided by

the USAID/OIG received an enthusiastic response and led to a 100 percent increase in OIG hotline calls from the region. In effect, the fraud awareness training program gave those with first-hand knowledge of the reconstruction program a leading role in deterring fraud and waste under the program. Since the beginning of the reconstruction program, we have provided quarterly briefings on our oversight efforts to the GAO, to USAID management, and to Congressional staff members. These briefings helped ensure that the USAID/OIG's oversight efforts were responsive to the needs of our customers and stakeholders.

- **Resources**—The supplemental appropriation provided a significant level of resources for oversight efforts. The \$1.5 million in additional operating expense funds for the USAID/OIG helped us add seven audit positions in the region and fund additional travel by criminal investigators. In effect, the additional resources allowed us to back up words with deeds.

Many people, when the Administration and the Congress began to discuss the reconstruction program for Central America and the Caribbean, anticipated some very serious problems with corruption and limited absorptive capacity in the region. We are very pleased that, working with the USAID missions and grantees and contractors in the region, we have been able to limit the problems to a relatively low level. The reconstruction program is still underway, and this is not the time to be satisfied. We are very conscious that more serious problems could develop or be discovered through our oversight program at any time. But so far, the USAID/OIG oversight program is doing what it was designed to do: make sure that reconstruction funds are well spent. 🏠